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In the Supreme Court of the United States

OCTOBER TERM, 1983

UNITED STATES OF AMERICA, PETITIONER

v.

KARL L. DAHLSTROM, ET AL.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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QUESTIONS PRESENTED

1. Whether, in a prosecution of promoters of an unlawful "tax shelter" program, the absence of a prior statute, regulation, or court decision directly establishing the illegality of the scheme precludes a finding of willfulness as a matter of law.

2. Whether the First Amendment bars prosecution of persons who advise and assist in structuring of sham transactions and preparation of false and fraudulent tax returns, on the ground that the returns were not filed immediately after the advice and assistance were given.

PARTIES TO THIS PROCEEDING

In addition to the parties shown in the caption, Hiram E. Conley, R. Bruce Ripley, David J. Morris, and Gaze Durst were appellants below and are respondents herein.

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

The Solicitor General, on behalf of the United States, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Ninth Circuit in this case.

OPINION BELOW

The decision of the court of appeals (App., *infra*, 1a-18a) is reported at 713 F.2d 1423.

JURISDICTION

The judgment of the court of appeals was entered on August 24, 1983. A petition for rehearing was denied on November 8, 1983 (App., *infra*, 19a). On December 30, 1983, Justice Rehnquist extended the time in which to file a petition for a writ of cer-

tiorari to and including February 6, 1984. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTE INVOLVED

Section 7206(2) of the Internal Revenue Code of 1954 (26 U.S.C.) provides:

> § 7206. Fraud and false statements
> Any person who—
>
> * * * * *
>
> Aid or assistance
>
> Willfully aids or assists in, or procures, counsels, or advises the preparation or presentation under, or in connection with any matter arising under, the internal revenue laws, of a return, affidavit, claim, or other document, which is fraudulent or is false as to any material matter, whether or not such falsity or fraud is with the knowledge or consent of the person authorized or required to present such return, affidavit, claim, or document;
>
> * * * * *
>
> shall be guilty of a felony and, upon conviction thereof, shall be fined not more than $5,000, or imprisoned not more than 3 years, or both, together with the costs of prosecution.[1]

STATEMENT

After a jury trial in the United States District Court for the Western District of Washington, respondents Karl L. Dahlstrom, Hiram E. Conley,

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[1] Section 7206(2) has since been amended to provide for fines of up to $100,000 (and $500,000 in the case of corporations). Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, § 329(c), 96 Stat. 618.

R. Bruce Ripley, David J. Morris, and Gaze Durst were convicted of conspiracy to defraud the United States, in violation of 18 U.S.C. 371. Each was also convicted on one or more counts of willfully aiding or assisting in, or procuring, counseling, or advising the preparation or presentation of a tax return or other document that is false or fraudulent as to any material matter, in violation of Section 7206(2) of the Internal Revenue Code of 1954 (26 U.S.C.). The district court sentenced respondents to various terms of imprisonment on the conspiracy count [2] and to concurrent terms of five years' probation on each of the substantive counts on which they were convicted, to commence upon release from custody. The court also imposed fines on Dahlstrom, Ripley, and Conley. (Tr. 4404-4407).

1. The evidence at trial showed that respondents promoted and sold a "tax shelter" program in which participants used a series of sham transactions and "gifts" to create inflated or entirely fictitious income tax deductions (Tr. 976-978, 1015-1016, 1019-1021, 3339, 3342-3343, 3345-3347, 3408, 3410). Sales of the program took the form of sales of membership in an organization formed by respondent Dahlstrom in 1974, the American Law Association (ALA) (Tr. 3021, 3339-3340, 3342).[3] As "members" of the ALA,

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[2] The prison terms imposed were as follows: Dahlstrom, five years; Ripley, four years; Conley, three years; Morris, eighteen months; and Durst, one year (Tr. 4404-4407).

[3] Although the ALA was nominally a membership organization, it was controlled by Dahlstrom. He was trustee of a trust organization which, in turn, was trustee of the ALA (Tr. 3421-3422). Ripley served as executive vice-president of the ALA (Tr. 3422-3423). Dahlstrom formed the ALA in order not to run afoul of laws prohibiting the practice of law without a license (Tr. 3021).

program purchasers were entitled to receive instruction and materials relating to the "tax shelter" program, conveyed at ALA two-day "seminars" (Tr. 1344-1348, 1388-1394, 1543-1548, 1665-1677, 1693, 1698, 1700-1701, 1798-1801, 1841-1846, 1854-1855, 2098-2099, 2101-2105, 2228-2229, 2253, 2261, 2266, 3023, 3111-3112, 3296-3297, 3351-3352, 3365-3367, 3524-3533, 3538-3540, 3558). "Membership fees" ranged from approximately $3,000-$6,000 in late 1976 to $12,000 in 1978 (Tr. 502, 772, 983, 1040, 1345-1346, 1545, 1666-1667, 1799, 1841, 2098, 2261, 3340). A member's fee payment was refundable if he was not satisfied with the program (Tr. 1841, 2099).

The "tax shelter" scheme was conceptually quite simple. Taxpayer participants would establish and retain control of a series of trusts. They would make payments to one of the trusts for purported materials or services. The payments would then be shifted among the trusts through paper transactions, at the conclusion of which one of the trusts would make a "gift" or "loan" back to the taxpayer of all or a large portion of the original payment. The taxpayer treated these payments to the trust as tax deductible business expenses; he treated the "gift" or "loan" as tax-free. The transactions, taken as a whole, had no economic substance; their sole purpose and effect was to generate phony tax deductions for the participants.

The particular version of this scheme promoted by respondents employed foreign trusts as the vehicle for carrying out the transactions and reducing the risk of detection by the Internal Revenue Service. The program participants would cause at least three common law trusts to be created in a foreign country

by a citizen of that country (Tr. 504-506, 774-781, 1052-1055, 1068-1083, 1548-1557, 1687-1693, 1801, 1806-1810, 1859-1871, 2103-2114, 2277-2281). Respondents would sometimes assist in setting up the trusts (Tr. 774-781, 790, 1052, 1858-1860, 2105-2107, 2277-2285). In general, the program participant himself, or a related person, would be named trustee of one of the trusts (trust number one) (Tr. 724, 1072, 1074, 1553-1554, 1692, 1808, 1861-1864, 2106-2107, 2272). Trust number one would, in turn, be named trustee of the other two trusts (trust number two and trust number three) (Tr. 1072, 1555-1557, 2109-2114, 2272; GXs 118-121, 178, 179, 180, 181, 182). Under this arrangement, the person implementing the "tax shelter" program or a related person would be in complete control of the affairs of all three trust organizations (see, *e.g.*, Tr. 1083-1112, 1558-1573, 1576, 1580-1585, 1704-1705, 1707-1708, 1710-1711, 1713-1715, 1884-1898).

Once established, these foreign trusts were used as described above. Dahlstrom or others conducting seminars advised the participants to make payments to trust number two for purported business expenses, and then to claim an income tax deduction for the full amounts (Tr. 1053-1057, 1083, 1085-1089, 1113, 1546-1547, 2275-2277, 3525-3530). After a series of prearranged transactions involving trusts two and three,[4] these amounts would ultimately be returned, in whole or in part, to the taxpayer as a so-called "gift" or "loan" from one of the trusts (Tr. 1393, 1581-

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[4] United States tax liability on the "income" to trust two from the payments from the taxpayer would be avoided by causing trust two to make payments to trust three. These payments would not give rise to United States tax liability because both trusts were non-resident aliens for tax purposes. App., *infra*, 4a.

1585, 1890-1898, 2123-2124, 2272, 3215-3217, 3233-3239).[5]

For example, James Murphy, one of the participants in the program, purported to purchase from his trust number two, for $66,000, "tax shelter" materials he had previously received from the ALA.[6] Although Murphy caused the entire $66,000 purchase price to be returned to him as a "gift" from trust number three, and he therefore incurred no real expense, he claimed the $66,000 "purchase" as a deduction on his income tax return for 1978. This was in accordance with advice he received from respondent Dahlstrom. Tr. 1050-1051, 1053-1055, 1068, 1094-1111, 1113; GX 1.

In another typical transaction, based on advice from an ALA seminar and respondent Morris, purchaser James Ira Howlett, a chiropractor, transferred a clinic building and his equipment to two number two trusts (Tr. 1837, 1866, 1872, 1878, 1881, 1898, 1908). He then made purported rental payments to these trust organizations and claimed income tax deductions amounting to $39,600 for 1979 with respect to the "payments" (Tr. 1881-1882, 1884-1887, 1907-1908). However, more than $21,000 of the "payments" ultimately returned to Howlett as "gifts" during 1979 (Tr. 1878-1879, 1888-1898).

In addition to counseling program participants to set up foreign trust organizations and claim false tax

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[5] The "gifts" or "loans" would generally take the form of a transfer from trust three to the taxpayer participant of a demand note payable by trust two. App., *infra*, 4a. There is no gift tax payable on gifts of intangible property by a nonresident alien to a United States citizen. 26 U.S.C. (& Supp. V) 2501.

[6] The record does not reveal how the materials were purportedly acquired by the trust.

deductions, respondents also counseled them to employ various methods for avoiding detection by the IRS. Respondent Morris provided participant Howlett false employer identification numbers to be used in connection with trust bank accounts (Tr. 1874-1877). Respondent Durst recommended that John Wilbur Ricketts set up additional trusts to make future transactions more difficult for the IRS to trace (GX 246, at 67-69). Respondents Ripley and Durst recommended that "tax shelter" purchasers use blue "copy-not" pens to sign checks, so that they would not be readable on any bank microfilm records that might be obtained by the IRS (Tr. 1686-1687; GX 246, at 85-92). Respondent Morris told Dr. Howard Bean to use specified fictitious names as the authorized signatures on bank accounts opened for his trusts, and accompanied Bean when he implemented this advice (Tr. 799-800, 804-809).

Respondent Durst counseled an IRS Special Agent posing as a participant's financial advisor that altering social security numbers on trust bank accounts was "another good thing to do * * * because * * * [without a social security number] there's no way the IRS will ever tie anything into you on any check over $10,000" (GX 246, at 94). Durst also warned the special agent, "If they get a hold of your books and records, they could probably shoot holes in this thing. * * * Yeah. If they do, you're in trouble" (GX 243B, at 23). He further stated that if the IRS obtained access to the participant's books and records, "Then you're talking about tax avoidance, tax fraud, and the whole thing" (GX 243B, at 26).[7]

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[7] Respondents also provided program purchasers with materials explaining the principle that the incidence of taxation

The evidence showed that purchasers of the ALA program were required to sign an ALA membership affidavit (see GX 212) stating that the member concerned did not work for a federal or state government, was not investigating respondents, and would not aid any government agency in any civil, criminal, or administrative action against respondents or the ALA. The affidavit also stated that the member would not divulge to any government agency any information concerning his relationship with respondents.

2. A divided panel of the Ninth Circuit reversed the convictions. The court held that the evidence was insufficient to establish that respondents had acted willfully. Citing *Brandenburg* v. *Ohio*, 395 U.S. 444, 447 (1969), the court also held that respondents' promotion of their "tax shelter" program was protected by the First Amendment because the actual filing of the fraudulent returns was not "imminent" at the time respondents counseled such action.[8] The court did not question the sufficiency of the evidence that respondents had aided or assisted in the preparation of false and fraudulent tax returns. Nor did the court question the adequacy of the evidence that respondents actually believed that their scheme was false and fraudulent. However, noting that no prior decision had invalidated the foreign trust organiza-

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is determined by the substance, rather than the form, of the transaction (*e.g.*, GX 304, at 86-90 of syllabus).

[8] The court also held that an additional reason for reversing the convictions on Count VII was that a false income tax return prepared by respondent Durst for a government informer was never actually filed as the informer's income tax return (App., *infra*, 11a-12a). Although we consider that ruling erroneous (see App., *infra*, 17a (dissenting opinion)), we are not seeking review of it by this Court.

tions involved in this case,[9] the court concluded that respondents could not possess the specific intent to violate Section 7206. App., *infra*, 8a-10a. The court also held that the insufficiency of the evidence of willfulness as to the substantive counts invalidated respondents' convictions on the conspiracy count as well (*id.* at 12a-13a).

Judge Goodwin, dissenting, reviewed the proof in the case and concluded: "There could hardly be any clearer evidence that the defendants in this case knew that what they were advising and assisting clients to do was patently illegal" (App., *infra*, 15a). He also rejected the majority's reliance on the First Amendment (*id.* at 18a).

REASONS FOR GRANTING THE PETITION

1. Schemes for fraudulent tax evasion are as numerous as human ingenuity can devise. Most—like the scheme involved here—are but variations on established themes. Like the jazz musician improvising on a popular tune, the tax evasion artist adapts the basic elements of the sham transaction to the needs and mood of the day, adding a twist here or a grace note there to maximize gain or reduce the risk of detection.

There is no doubt that respondents' "tax shelter" program was illegal, and the government's evidence in this case clearly established that respondents knew and understood that it was illegal. Legitimate tax advisers do not advocate that their clients write their checks with "copy-not" pens, so that bank microfilms will not be readable by the IRS. They do not provide false social security numbers to prevent the IRS

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[9] Similar schemes have since been held to be invalid for tax purposes. *United States* v. *Landsberger*, 692 F.2d 501 (8th Cir. 1982); *Zmuda* v. *Commissioner*, 79 T.C. 714 (1982), appeal pending, No. 83-7374 (9th Cir. filed May 23, 1983).

from "ever tie[ing] anything into you" ([GX 246, at 94). They do not suggest fictitious names for authorized signatures on bank accounts. They do not require their clients to sign an affidavit forswearing any cooperation with tax authorities that may be investigating them. They do not advise their clients that disclosure of their books and records to the IRS would lead to prosecution for "tax avoidance, tax fraud, and the whole thing" (GX 243B, at 26). When they do these things—as the evidence here proves respondents did—the jury cannot be faulted for finding that they believed their scheme to be unlawful, and thus that they acted willfully.

The court of appeals held, however, that a defendant does not willfully counsel and assist in the preparation of false and fraudulent tax returns if the scheme he promotes has not yet been invalidated under "clearly relevant precedent" (App., *infra*, 9a). According to the court, it does not matter whether the defendant has manifested an intent to assist in defrauding the government; the absence of a prior "statute, regulation, or court decision" in point precludes criminal prosecution (*id.* at 13a). The court thus effectively removed the threat of criminal liability from any tax evasion counselor creative enough to devise an as-yet-unchallenged variety of tax fraud. The result here was to overturn the convictions of five individuals who counseled and assisted in the preparation of false and fraudulent tax returns, and who plainly believed at the time that their tax evasion scheme was unlawful. We submit that the court of appeals erred, and that the decision represents a severe blow to the ability to enforce the tax laws effectively. Review of the decision by this Court is therefore entirely warranted.

a. The court's holding that the absence of a statute, regulation, or court decision directly on point pre-

cludes prosecution under Section 7206(2) is unworkable in practice and erroneous as a matter of law. It is far too easy for promoters of tax evasion programs to devise a new scheme, not yet anticipated by the IRS or litigated in court. It should suffice to prove that the promoters' program was fraudulent and that the promoters recognized that it was fraudulent; to require the existence of an advance ruling would cripple law enforcement. Accordingly, the courts have frequently sustained criminal tax prosecutions based on the general concept of sham transactions, provided there is evidence of actual fraudulent intent. See, *e.g.*, *United States* v. *Baskes*, 687 F.2d 165 (7th Cir. 1981); *United States* v. *Conforte*, 624 F.2d 869, 873-875 (9th Cir.), cert. denied, 449 U.S. 1012 (1980); *United States* v. *Turkish*, 623 F.2d 769, 771 (2d Cir. 1980), cert. denied, 449 U.S. 1077 (1981); *United States* v. *Clardy*, 612 F.2d 1139, 1151-1153 (9th Cir. 1980); *United States* v. *Fruehauf Corp.*, 577 F.2d 1038, 1068 (6th Cir.), cert. denied, 439 U.S. 953 (1978); *United States* v. *Raub*, 177 F.2d 312, 313-314 (7th Cir. 1949).

Willfulness under Section 7206(2) depends not on whether the IRS and the courts have had the chance to rule authoritatively on a particular scheme. It depends on whether the scheme was in fact unlawful and whether the defendant believed the scheme was unlawful. The court of appeals' contrary holding simply invites fraud and puts a premium on criminal ingenuity.

The scienter requirement of the offenses involved in tax crimes—willfulness—"relieve[s] the statute of the objection that it punishes without warning an offense of which the accused was unaware." *Screws* v. *United States*, 325 U.S. 91, 102 (1945); see *Boyce Motor Lines, Inc.* v. *United States*, 342 U.S. 337, 342 (1952); *United States* v. *Ragen*, 314 U.S. 513, 524

(1942); *Gorin* v. *United States*, 312 U.S. 19, 26-28 (1941); *Hygrade Products Co.* v. *Sherman*, 266 U.S. 497, 502-503 (1925). As this Court stated in *United States* v. *Bishop*, 412 U.S. 346, 361 (1973), the willfulness requirement of Section 7206 is intended to "separate the purposeful tax violator from the well-meaning, but easily confused, mass of taxpayers."

Willfulness is thus a question of subjective intent. The issue is the defendant's own state of mind, not the objective certainty or uncertainty of the law. See *United States* v. *Herzog*, 632 F.2d 469, 473 (5th Cir. 1980). To turn it about, as the court of appeals did, and say that uncertainties about the application of the law preclude prosecution even of those who clearly knew they were committing, and intended to commit, a violation, is to ignore the very purpose of the requirement of specific intent. *Boyce Motor Lines*, 342 U.S. at 342; *Screws*, 325 U.S. at 102-103. As Justice Brandeis said for the Court concerning a similar contention over 65 years ago, "any danger to [potential violators] which might otherwise arise from indefiniteness, is removed by [the statute's scienter requirement]." *Omaechevarria* v. *Idaho*, 246 U.S. 343, 348 (1918). The principle still holds today. See *Colautti* v. *Franklin*, 439 U.S. 379, 395 & n.13 (1979).[10]

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[10] We can agree that in some circumstances a criminal prosecution would violate due process because the law is so vague that it fails to "give a person of ordinary intelligence fair notice that his contemplated conduct is forbidden." *United States* v. *Harriss*, 347 U.S. 612, 617 (1954); see *United States* v. *Ingredient Technology Corp.*, 698 F.2d 88, 96 (2d Cir. 1983), cert. denied, No. 82-1526 (June 20, 1983). The court of appeals reached no such conclusion here. The court held that respondents' conduct was not willful—not that Section 7206(2) is unconstitutionally vague. In any event, where proof of willfulness is required to sustain a conviction, we

Practical considerations of legislative draftsmanship compel this conclusion. As this Court observed in *Boyce Motor Lines*, 342 U.S. at 340 (footnote omitted):

> [M]ost statutes must deal with untold and unforeseen variations in factual situations, and the practical necessities of discharging the business of government inevitably limit the specificity with which legislators can spell out prohibitions. Consequently, no more than a reasonable degree of certainty can be demanded. Nor is it unfair to require that one who deliberately goes perilously close to an area of proscribed conduct shall take the risk that he may cross the line.

These "practical necessities" are as compelling in the context of the tax laws as in any other. *Bishop*, 412 U.S. at 360-361.

Of course, in a prosecution under Section 7206(2) defendants are entitled to present evidence to show that they did not believe that their actions were unlawful, and therefore did not act willfully. Such evidence may take many forms (see *United States* v. *Brown*, 411 F.2d 1134, 1137 (10th Cir. 1969)), but its purpose is always to show their *actual state of mind*. Respondents had this opportunity, but the jury did not decide in their favor. See *United States* v. *Pomponio*, 563 F.2d 659, 662 (4th Cir. 1977), cert. denied, 435 U.S. 942 (1978). The court of appeals erred in concluding that the existence of some objective uncertainty in the law negates criminal intent, where the respondents themselves were shown to be-

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believe due process requirements of definiteness are usually satisfied. *Boyce Motor Lines*, 342 U.S. at 340; *United States* v. *McClain*, 545 F.2d 988, 1001-1002 n.30 (5th Cir. 1977). See *United States* v. *Ragen*, 314 U.S. at 524 ("A mind intent upon willful evasion is inconsistent with surprised innocence."); cf. *Lambert* v. *California*, 355 U.S. 225 (1957).

lieve that the actions they counseled were unlawful. *United States* v. *Ingredient Technology Corp.*, 698 F.2d 88, 96 (2d Cir. 1983), cert. denied, No. 82-1526 (June 20, 1983).[11]

Here, the jury heard ample evidence concerning respondents' efforts to assist participants in concealing their transactions. The jury also learned that respondents informed the participants of the very principle of tax law—substance over form—violated by their scheme, and that respondent Durst had told a participant that if the IRS were to discover his books and records, "then you're talking about tax avoidance, tax fraud, and the whole thing" (GX 243B, at 26). This provides a sufficient basis for concluding that respondents' violation of the law was willful. *Holland* v. *United States*, 348 U.S. 121 (1954); *Spies* v. *United States*, 317 U.S. 492, 499 (1943); *United States* v. *Kaatz*, 705 F.2d 1237, 1246 (10th Cir. 1983); *United States* v. *Scott*, 660 F.2d 1145, 1160 (7th Cir. 1981), cert. denied, 455 U.S. 907 (1982); *United States* v. *Voorhies*, 658 F.2d 710, 715 (9th Cir. 1981); *United States* v. *Tunnell*, 481 F.2d 149, 152 (5th Cir. 1973), cert. denied, 415 U.S. 948 (1974); *Greenberg* v. *United States*, 295 F.2d 903, 907 (1st Cir. 1961); see *Moore* v. *Commissioner*, 619 F.2d 619 (6th Cir. 1980). The issues of uncertainty in the law raised by respondents, as in *Pomponio*, 563 F.2d at 662, "constitute no more than defenses which were rejected by the jury." The court of appeals invaded the province of the jury in hold-

[11] Conversely, it may be well settled as a legal matter that a certain tax treatment of a transaction is unlawful, yet a defendant in a criminal case would have a valid defense if the jury found that—however erroneously as a matter of objective fact—he actually believed his course of action to be proper. See, *e.g.*, *Mann* v. *United States*, 319 F.2d 404, 409 (5th Cir. 1963), cert. denied, 375 U.S. 986 (1964).

ing, on this record, that respondents' conduct could not as a matter of law be found to have been "willful."

b. The decision below squarely conflicts with *Ingredient Technology Corp.* In that case, the Second Circuit rejected the theory that "uncertainty in the law negates willfulness whether or not the defendants are actually confused about the extent of their tax liability" (698 F.2d at 97). The court stated that "prior cases on willfulness consistently require factual evidence of the defendants' state of mind to negate willfulness under any theory" (*ibid.*). There, as here, "there was no evidence that [the defendants] * * * genuinely thought that what they were doing was lawful and proper; on the contrary, their conduct indicated a subjective belief in the *un*lawfulness of the conduct" (*ibid.* (emphasis in original)).[12]

For its contrary holding, the court of appeals relied (App., *infra*, 9a) on *United States* v. *Critzer*, 498 F.2d 1160 (4th Cir. 1974), and *United States* v. *Garber*, 607 F.2d 92 (5th Cir. 1979) (en banc). Those decisions, however, are factually distinguishable in material respects and provide only slight support for the court of appeals' reasoning.

In *Critzer*, the defendant, an Eastern Cherokee Indian, had been advised by the Bureau of Indian Affairs that her income in question was not taxable. Indeed, the Bureau continued to maintain that position at the time of trial. The Fourth Circuit held that "[a]s a matter of law, defendant cannot be

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[12] The *Ingredient Technology* court also rejected the notion that a criminal tax statute could be unconstitutionally vague merely because " 'there is no litigated fact pattern precisely in point.' " 698 F.2d at 96 (quoting *United States* v. *Brown*, 555 F.2d 336, 339-340 (2d Cir. 1977)).

guilty of willfully evading and defeating income taxes on income, the taxability of which is so uncertain that even co-ordinate branches of the United States Government plausibly reach directly opposing conclusions" (498 F.2d at 1162).

We have little objection to the narrow holding of *Critzer*—that a taxpayer should not be found to have acted willfully if she relied on advice from a responsible agency of the federal government—especially under the facts of the case, which involved an Indian and the agency of the federal government charged with looking after her affairs. This narrow holding has no application to the instant case, however, because here there is no conflict between government agencies and no evidence that respondents relied on statements or positions of the government.

We take issue with the broader dicta of *Critzer*, that in a case of legal uncertainty the "defendant's actual intent is irrelevant" (498 F.2d at 1162), and that "when the law is vague or highly debatable, a defendant—actually or imputedly—lacks the requisite intent to violate it" (*ibid.* (quoted at App., *infra*, 9a)). On the contrary, the issue of intent is one of fact, to be decided by the jury. *Morissette* v. *United States*, 342 U.S. 246 (1952). Where, as here, there is ample evidence that the defendants had the requisite intent to violate the law, and there was no evidence of reliance on government positions, the purely legal issues concerning the uncertainty of the law do not preclude conviction.

In *Garber*, the Fifth Circuit held that, where there is sufficient uncertainty in the law, the trial court must allow the defendant to introduce expert testimony on that uncertainty, and must instruct the jury that a reasonable misconception of the tax law on

his part would negate the necessary intent.[13] Unlike the court below, the *Garber* court did not hold that the perceived legal uncertainty was a bar to conviction; on the contrary, it remanded for retrial with the expert evidence and revised jury instructions, thereby leaving the question of willfulness within the province of the jury. 607 F.2d at 100.

Garber thus does not support, but rather conflicts with, the result below. Respondents were permitted to introduce expert testimony concerning the purported uncertainty in the law (see Tr. 3784-3823, 3832-3869, 3878-3941),[14] and the trial court properly instructed the jury that respondents could not be found guilty if they had a good faith belief in the lawfulness of their tax program (R. 341, Instruction 29). The jury nonetheless found respondents guilty of willful violations of Section 7206(2). Respondents' convictions were fully consistent with the Fifth Circuit's position in *Garber*.

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[13] The Fifth Circuit has subsequently narrowed the application of *Garber* to cases involving failure to report income, and has refused to apply it to a case of filing false information. *United States* v. *Herzog*, 632 F.2d 469, 473 (1980). The court reasoned that "no amount of expert testimony could help" a defendant who filed falsely (*ibid.*).

[14] We do not agree with the *Garber* court (607 F.2d at 98) that proof of uncertainty in the law is relevant where the defendant was not aware of the uncertainty. In our view, the ultimate issue is the defendant's subjective intent; the objective state of the law is not ordinarily probative of that intent. See *id.* at 113 (Tjoflat, J., dissenting). To the limited extent that proof of uncertainty in the law might add credence to the defendant's own claim of subjective good faith, its relevance is likely to be outweighed by the dangers of prejudice and confusion (*ibid.*). Because expert testimony was admitted in this case, however, the issue is not presented.

In *Critzer*, the court relied heavily on *James* v. *United States*, 366 U.S. 213 (1961), in which this Court reviewed a conviction for failing to report income from embezzled funds. In an earlier decision, *Commissioner* v. *Wilcox*, 327 U.S. 404 (1946), the Court had held that embezzled funds did not constitute taxable income to the embezzler. In *James*, the Court overruled *Wilcox* but nonetheless reversed the conviction. A three-justice plurality held that "the element of willfulness could not be proven in a criminal prosecution" in light of the prior inconsistent holding in *Wilcox*. 336 U.S. at 221-222.

The *Critzer* court concluded from *James* that "when the law is vague or highly debatable, a defendant * * * lacks the requisite intent to violate it" (498 F.2d at 1162). We do not believe this sweeping conclusion can be appropriately drawn from the rather unusual circumstances of *James*. In *James*, the three dissenting justices concluded that the permissibility of retrial of the defendants depended on their actual reliance, if any, on *Wilcox* (366 U.S. at 241, 242-243). The three concurring justices, who dissented on the question of overruling *Wilcox*, necessarily agreed with the plurality that the conviction should be reversed, but two of them—Justices Black and Douglas—criticized the plurality's decision to make its holding prospective only.[15] Only the three justices in the plurality

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[15] The concurring and dissenting opinion of Justices Black and Douglas in *James* has been a source of some confusion. We believe that the opinion states: (1) that the willfulness requirement was satisfied in *James* despite the legal uncertainty (366 U.S. at 223); (2) that the Court could not legitimately apply interpretations of criminal statutes prospectively (*id.* at 225); and (3) that a statute so ambiguous that interpretation of it brings about unexpected results raises serious questions of unconstitutional vagueness (*id.* at 224). Con-

subscribed to the statement relied on in *Critzer*. Moreover, this Court subsequently characterized *James* as holding merely that "[t]he requirement of an offense committed 'willfully' is not met * * * if a taxpayer *has relied in good faith* on a prior decision of this Court" (*Bishop*, 412 U.S. at 361 (emphasis added)). Thus, *James* cannot properly be read to stand for a constitutional rule that would preclude prosecution of defendants evincing the requisite mens rea and committing acts illegal in fact simply because there may have been some objective uncertainty about the illegality of their actions.

In any event, *James* is a far cry from the instant case. We can agree there is some unfairness in punishing conduct that was expressly upheld by governing Supreme Court precedent at the time it was engaged in. We do not think there is any unfairness in convicting persons who acted both unlawfully and willfully, and in a manner not theretofore held lawful by any court or agency, where their sole substantiated claim is that no case directly in point had yet actually invalidated the specifics of their scheme.

c. The court of appeals' decision is particularly troublesome because the legal uncertainty it deemed dispositive—the question of the validity of foreign trusts [16]—was a wholly collateral issue of law. Any confusion there may have been concerning the law of foreign trusts was simply irrelevant here. It was

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trary to the *Critzer* court (498 F.2d at 1163 n.5), these views do not support the *James* plurality "on the point in issue"; nor do they support the holding in the instant case.

[16] "The government, however, has not pointed to any cases which invalidated the FTO's [Foreign Trust Organizations] presented in this particular case" (App., *infra*, 8a). "The use of foreign trusts to save taxes was still a highly debatable issue" (*ibid.*).

the nature of the transactions, rather than the nature of the entities, that made respondents' scheme fraudulent.

As the dissent pointed out (App., *infra*, 14a), this case is governed by "settled principles of tax law regarding sham 'gifts' and transactions." Those principles clearly established that the transactions respondents advocated were blatantly fraudulent. Under respondents' scheme, a user would claim as a deduction the amount of money paid to a trust as a purported business expenditure. But he would retain control of the money and, pursuant to a prestructured scheme, ultimately cause all or a portion of the money to return to himself as a so-called "gift" [17] or "loan."

This Court has held that in determining tax consequences, the economic realities of the transaction, rather than its form, are controlling. *Frank Lyon Co.* v. *United States*, 435 U.S. 561, 573 (1978); *Knetsch* v. *United States*, 364 U.S. 361 (1960); *Commissioner* v. *Court Holding Co.*, 324 U.S. 331, 334 (1945); *Higgins* v. *Smith*, 308 U.S. 473, 477 (1940); *Gregory* v. *Helvering*, 293 U.S. 465, 469-470 (1935). Further, in determining the substance of a transaction, it is necessary to view the transaction as a whole, taking into consideration each of its steps. *Court Holding Co.*, 324 U.S. at 334; *Minnesota Tea*

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[17] In his dissent,, Judge Goodwin correctly concluded (App., *infra*, 14a): "There were no 'gifts' here within the clear intent of the statute because the taxpayers controlled the transactions of their trusts. See *Hilda M. Royce*, 18 T.C. 761 (1952); see also *Jackson*, 32 BTA 470 (1935); *Stine*, 32 BTA 482 (1935)." Moreover, as part of a prestructured transaction the "gift" was plainly in consideration of the expenditure, and therefore was not a gift within the contemplation of the tax laws. See *Commissioner* v. *Duberstein*, 363 U.S. 278, 285 (1960).

Co. v. *Helvering*, 302 U.S. 609, 613 (1938). Here the "gift" or "loan" was but a part of a single integrated transaction, and must be viewed as a reimbursement of the earlier payment. Thus, the full amount of the expenditure could not be claimed as a deduction; it had to be reduced by the amount of the "gift" or "loan." See *Manocchio* v. *Commissioner*, 710 F.2d 1400, 1402 (9th Cir. 1983); *United States* v. *Daniels*, 617 F.2d 146, 147-148 (5th Cir. 1980); *Glendinning, McLeish & Co.* v. *Commissioner*, 61 F.2d 950 (2d Cir. 1932); see also *United States* v. *Fruehauf Corp.*, 577 F.2d 1038, 1067-1068 (6th Cir.), cert. denied, 439 U.S. 953 (1978).

Even if all uncertainties in the use of foreign trusts were resolved in favor of the taxpayer, respondents' scheme would still be illegal. Regardless of the entities or persons involved (see *Griffiths* v. *Commissioner*, 308 U.S. 355, 357-358 (1939)), the transactions used to create deductions in this case were shams and could not be recognized for tax purposes.

Respondents' scheme is similar in this respect to that found to support criminal liability in *United States* v. *Baskes*, 687 F.2d 165 (7th Cir. 1981). There, the defendant assisted in the establishment of foreign trusts for the purpose of disguising a fraudulent form of commodity tax straddle. The taxpayers then engaged in risk-free commodity transactions in which losses generated in the United States (and deducted from income taxes) were offset by gains to the foreign trusts. Based on evidence of criminal intent,[18] the court upheld Baskes' conviction under Section

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[18] The defendant in *Baskes*, like respondents here, argued that his conduct was not willful because he could reasonably have believed the domestic commodity trade losses were deductible.

7206(2). There, as here, the validity *vel non* of the foreign trusts was irrelevant to the prosecution; there, as here, the foreign trusts were mere vehicles for sham transactions.

Respondents attempted to conceal the fictitious nature of the deductions created through use of the ALA program by covering them with a facade of apparent legality. By focusing on the validity of the trusts, rather than on the nature of the transactions accomplished through use of the trusts, the court of appeals was misled by the deception and was distracted from the substance of the transaction. This makes the court's holding all the more troublesome, for it extends the immunity from prosecution for violations of "uncertain" tax laws to tax evasion schemes involving any "uncertain" element—even where that uncertainty could not possibly give rise to any doubt about the fraudulent character of the overall scheme.[19]

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[19] On the basis of its holding on the substantive counts, the court of appeals also held that there was insufficient evidence of criminal intent to sustain the conspiracy convictions (App., *infra*, 12a-13a). It reasoned that the substantive offenses underlying the conspiracy count were violations of Section 7206(2); if there was insufficient evidence to support a finding of willful violations of Section 7206(2), the court reasoned, there could be no conviction on the conspiracy count either. However, the indictment here alleged a conspiracy to defraud the United States, not to commit a particular offense. Consequently, the necessary intent is to interfere with or impair a governmental function by deceit, craft, or trickery. *Hammerschmidt* v. *United States*, 265 U.S. 182, 188 (1924). Here, as discussed above, there was ample evidence that the respondents intended to impair the government's tax collection efforts by deceit, craft, or trickery. Thus, the evidence was sufficient to sustain the conspiracy convictions even if, as the court held, respondents could not be convicted on the substantive counts. *United States* v. *Klein*, 247 F.2d 908 (2d Cir. 1957), cert.

2. The court of appeals also held that promotion of a fraudulent tax avoidance scheme of this sort is protected by the First Amendment.[20] This holding conflicts with decisions of this and other courts, embodies a fundamental misconception about the scope of First Amendment protections, and is gravely injurious to the government's efforts to prevent and deter fraudulent and abusive "tax shelter" promotions.

a. Relying on *Brandenburg* v. *Ohio*, 395 U.S. 444, 447 (1969), the court of appeals stated (App., *infra*, 10a (deletions in original)):

> Nothing should be clearer at this stage in the development of first amendment jurisprudence than "the principle that the constitutional guarantees of free speech and free press do not permit a State to forbid or proscribe advocacy . . . of law violation except where such advocay is directed to inciting or producing imminent lawless action and is likely to incite or produce such action."

The court of appeals did not explain its understanding of the term "imminent," nor did it cite any other decisions bearing on the application of the First Amendment to speech employed to instigate unlawful conduct. The court simply concluded, without analysis, that "[n]othing in the record indicates that the advocacy practiced by these defendants contemplated *imminent* lawless action" (App., *infra*, 10a (emphasis

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denied, 355 U.S. 924 (1958). In any event, if this Court agrees with our position regarding the substantive counts, the reversal of respondents' convictions on the conspiracy count will not stand.

[20] For purposes of this alternative holding, the court expressly assumed—contrary to its holding—that respondents "knew that a taxpayer who actually performed the actions they advocated would be acting illegally" (App., *infra*, 10a).

in original)). The court thus held that "the first amendment would require a further inquiry before a criminal penalty could be enforced" (*ibid.*).[21]

In the specific context of tax evasion, the decision is in conflict with decisions of the Eighth Circuit in *United States* v. *Moss*, 604 F.2d 569 (8th Cir. 1979), cert. denied, 444 U.S. 1071 (1980), and *United States* v. *Buttorff*, 572 F.2d 619 (8th Cir.), cert. denied, 437 U.S. 906 (1978). In *Buttorff* and *Moss*, the defendants were convicted of aiding and abetting the filing of fraudulent income tax withholding forms, in violation of 26 U.S.C. (Supp. V) 7205 and 18 U.S.C. 2. They had made speeches in which they advised taxpayers how to file false withholding forms, and taxpayers had followed their advice. The convictions were upheld against First Amendment challenge, without any requirement that unlawful action be immediate.

The decision below is also difficult to reconcile with *United States* v. *Damon*, 676 F.2d 1060, 1062 (5th Cir. 1982), in which the Fifth Circuit rejected a defense assertion that 26 U.S.C. 7206(2) violated the First Amendment. The court held that the conduct proscribed by Section 7206(2) "can not be considered 'pure speech'" (676 F.2d at 1062). Analyzing the statute in light of *Brandenburg*, the court determined (*ibid.* (citations omitted)):

> The statute here involved proscribes only purposefully incited imminent lawless activity. This is clearly discerned from the commonly under-

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[21] The court did not explain what "further inquiry" might be in order. In light of the court's conclusion that "concern with protecting the public fisc" cannot "justify" criminal prosecution for speech of this kind (App., *infra*, 10a), we can envision no further proceedings that could cure the alleged constitutional defect in this prosecution.

stood meanings of "procure," "counsel" and "advise," and from judicial interpretations of the statute itself. The type of incitive speech with which we are here concerned is surely not constitutionally protected speech.

Moreover, the court of appeals has misconstrued this Court's decisions. Speech that incites unlawful conduct is not protected merely because the conduct is not completed immediately. The fundamental principle, derived from the common law, is "that a person who procures another to do an act is responsible for that act as though he had done it himself." *Dennis* v. *United States*, 341 U.S. 494, 545 (1951) (Frankfurter, J., concurring); see *Yates* v. *United States*, 354 U.S. 298, 320 (1957); *Fox* v. *Washington*, 236 U.S. 273, 277-278 (1915).[22] The issue is causation, not timing. Where protected speech—especially political rhetoric—is involved, however, the courts have looked to proximity in time as an objective indicator of causation. A speaker thus cannot be held responsible for the remote consequences of his speech. See *Brandenburg*, 395 U.S. at 447.

The *Brandenburg* rule has recently been restated by this Court in *NAACP* v. *Claiborne Hardware Co.*, 458 U.S. 886, 927 (1982): "a finding that [a person's] public speeches were likely to incite lawless action could justify holding him liable for unlawful conduct that in fact followed within a reasonable period." At issue in *Claiborne Hardware* were the

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[22] Significantly, federal statutes directed at promoters of abusive tax shelters are predicated on the congressional judgment that the "professional advisor or salesman of a tax shelter is generally *more culpable* than the purchaser who may have relied on their representat[ions] as to the tax consequences of the investment." 1 S. Rep. 97-494, 97th Cong., 2d Sess. 266 (1982) (emphasis added).

speeches of NAACP State Secretary Charles Evers, described by the Court as "spontaneous and emotional appeals for unity and action in a common cause" (*id.* at 928). The lower courts had held Evers liable for damages to property caused some time after the speech. A "reasonable period" for determining whether Evers could be held responsible for the subsequent acts of violence, according to this Court, was no more than "weeks or months" (*ibid.*). Here, there was pecuniarily motivated counseling of fraudulent tax transactions that led to prompt preliminary steps by program participants to implement respondents' program. See, *e.g.*, Tr. 1036-1037, 1047-1056, 1094-1113, 1840-1850, 1858-1869.

While the actual filing of false tax returns occurred somewhat later, it is absurd to suggest in the tax evasion context that the fraudulent return must be filed immediately on the heels of the tax promoter's counsel and assistance. Unlike the flash of violence that may follow an inflammatory speech, a tax evasion scheme requires time. In this case, the trust organizations recommended by respondents had to be set up (a process inevitably more time-consuming because done abroad), the paper transactions had to be carried out, and the tax returns had to be prepared. Moreover, the transactions had to take place during the year for which taxes were to be evaded, whereas participants would not complete their unlawful activity until the time to file tax returns—usually April 15 of the following year. To find such conduct insufficiently "imminent" as a matter of constitutional law is to insulate virtually all tax evasion promotion schemes from punishment.[23]

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[23] The court of appeals' holding could lead to the wholly irrational result that those who counsel and advise the filing of false tax returns early in the tax year are constitutionally

b. The court of appeals compounded its error by treating this as a case of pure speech within the core protections of the First Amendment, like that in *Brandenburg* and *Claiborne Hardware*, when in fact it involved extensive conduct other than speech, directly leading to actual violations of law. Moreover, the court disregarded the fact that the speech itself was less-protected, commercial speech.

Respondents were not prosecuted for mere advocacy of violation of the tax laws. Their conduct went far beyond mere speech. In addition to respondent Durst's assistance in the preparation of a false individual tax return, recognized by the court of appeals (App., *infra*, 10a), respondents provided materials to assist in carrying out the "tax shelter" program, set up foreign trust organizations for some participants, provided false social security numbers and suggested fictitious names for use on authorized bank account records, and accompanied some participants to assist them in opening accounts under phony names. They also distributed and required program participants to sign affidavits pledging to withhold cooperation from law enforcement authorities. See pages 3-8, *supra*. The court of appeals' conclusion that their activities fell within First Amendment protections is thus contrary to this Court's holding that "the constitutional freedom for speech and press * * * [does not extend] its immunity to speech or writing used as an integral part of conduct in violation of a valid criminal statute." *Giboney* v. *Empire Storage & Ice Co.*, 336 U.S. 490, 498 (1949).

The court of appeals also disregarded the commercial character of respondents' speech. Respondents'

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protected, but that those who give their advice and counsel on April 14 (when it is ordinarily too late to put it to use in the returns about to be filed) are not.

speech was simply a service, sold to the participants for a price. Cf. *Ohralik* v. *Ohio State Bar Association*, 436 U.S. 447, 456-457, 459 (1978). But this Court has unequivocally held that "[t]he government may ban * * * commercial speech related to illegal activity." *Central Hudson Gas & Electric Corp.* v. *Public Service Commission*, 447 U.S. 557, 563-564 (1980), citing *Pittsburgh Press Co.* v. *Human Relations Commission*, 413 U.S. 376, 388 (1973). See *Village of Hoffman Estates* v. *Flipside, Hoffman Estates, Inc.*, 455 U.S. 489, 496 (1982); see also *Lamar Outdoor Advertising* v. *Mississippi State Tax Commission*, 701 F.2d 314, 323 (5th Cir. 1983); *Casbah, Inc.* v. *Thone*, 651 F.2d 551, 564 (8th Cir. 1981), cert. denied, 455 U.S. 1005 (1982). Thus, under the decisions of this Court respondents can legitimately claim no constitutional right to sell "how-to" materials on breaking the law.

3. The decision in this case, if not reversed, will seriously interfere with the collection of the revenue. Our tax system depends to a large degree on voluntary compliance. Fraudulent tax evasion schemes are doubly pernicious: not only do they lead participants to file false and fraudulent returns; they also undermine the vital national sense that conscientious tax reporting is a shared obligation of all. See 1 S. Rep. 97-494, 97th Cong., 2d Sess. 266 (1982) Moreover, as a question of law enforcement strategy, "[a]busive tax shelters must be attacked at their source: the organizer and salesman" (*ibid.*). Combatting organized tax evasion promotion schemes, such as respondents', is therefore one of the highest priorities of the IRS (General Accounting Office, *With Better Management Information, IRS Could Further Improve Its Efforts Against Abusive Tax Shelters* 1, 6-7, 30-33 (1983)). The IRS reports that some 340,000 returns are currently under audit be-

cause of potential tax shelter questions, and that 18,570 out of some 58,000 cases docketed in the Tax Court as of November 30, 1983, involved tax shelter issues. The abusive tax shelter problem is also a source of grave concern in Congress.[24]

The decision below borders on the irresponsible. Both of the alternative holdings serve to frustrate the fair and effective enforcement of tax obligations. The holding regarding willfulness will encourage the proliferation of abusive tax shelters, as promoters discover that they can avoid criminal responsibility *even for knowingly fraudulent schemes*, if they can but devise a variation not anticipated by statute, regulation, or case law. Especially given the way the court of appeals evaluated the scheme in this case, it will be a rare case where prior precedent is so clear that a nonfrivolous claim of uncertainty cannot be made. The First Amendment holding will give promoters the confidence that—at least if their schemes are not carried out *immediately*—they will be cloaked with the protections of the First Amendment.

As applied in the Ninth Circuit alone, the decision is troubling, for it affects a large population and creates an inconsistency in national standards of tax law enforcement.[25] And even if the holding below is

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[24] In 1982, Congress enacted several measures specifically directed against abusive tax shelters, including a penalty for promoting abusive tax shelters (codified at 26 U.S.C. 6700); a procedure for enjoining promoters of abusive tax shelters (codified at 26 U.S.C. 7408); and new penalties for substantial understatements (codified at 26 U.S.C. 6661). See Pub. L. No. 97-248, §§ 320(a), 321(a), and 323(a), 96 Stat. 611, 612, and 613.

[25] Even before *Dahlstrom* was decided, the United States District Court for the Eastern District of Wisconsin granted

rejected by other courts, it will lend credence to the claims and pretensions of abusive tax shelter promoters, whose best tactic is to play on the limited legal understanding of the public.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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protest leader Alton R. Moss, a/k/a John L. Freeman, an acquittal on the ground that his advising taxpayers to violate the tax laws was protected by the First Amendment, even though the taxpayer committed violations on his advice. (No. 81-CR-112; see R. 336). *Dahlstrom* could lead to more district court actions of that sort.

APPENDIX A

UNITED STATES COURT OF APPEALS
NINTH CIRCUIT

Nos. 82-1137, 82-1141, 82-1138, 82-1142 and 82-1143

UNITED STATES OF AMERICA, PLAINTIFF-APPELLEE

v.

KARL L. DAHLSTROM, R. BRUCE RIPLEY, HIRAM E. CONLEY, DAVID J. MORRIS, and GAZE DURST,
DEFENDANTS-APPELLANTS

Argued and Submitted March 10, 1983

Decided Aug. 24, 1983

Appeal from the United States District Court
for the Western District of Washington

Before GOODWIN, ALARCON, and FERGUSON, Circuit Judges.

Appellants Dahlstrom, Ripley, Conley, Morris and Durst were convicted by a jury of conspiracy to defraud the United States. 18 U.S.C. § 371, and of aiding and abetting the preparation and presentation of fraudulent income tax returns. 26 U.S.C. § 7206(2). Each appellant contends the evidence was insufficient

to sustain a conviction as to the crimes charged against him. We agree.

I. STANDARD OF REVIEW

In determining whether a jury verdict rests on sufficient evidence, a reviewing court must view the evidence in the light most favorable to the prosecution and determine "whether any rational trier of fact could have found the essential elements of the crime beyond a reasonable doubt." *Jackson v. Virginia*, 443 U.S. 307, 319, 99 S.Ct. 2781, 2789, 61 L.Ed.2d 560 (1979); *United States v. Universal Trade and Industries*, 695 F.2d 1151, 1153 (9th Cir. 1983).

II. PROCEDURAL BACKGROUND

Appellants were charged in a seven-count criminal indictment brought by the United States. Count I charged all five appellants with conspiracy to defraud the government in violation of 18 U.S.C. § 371. Counts II through VII charged one or more of the appellants with violations of section 7206(2) of the Internal Revenue Code.

Dahlstrom and Ripley were indicted under all of the counts. Dahlstrom was convicted under every count save count IV, and Ripley was convicted under counts I, III and V. Conley was charged and convicted under counts I, II, VI, and VII. Morris was charged and convicted under counts I and V, while Durst was both charged and convicted under counts I and VII.

The district court sentenced each appellant to imprisonment on count I: Dahlstrom for five years, Ripley for four years, Conley for three years, Morris for 18 months and Durst for one year. The court also

sentenced each appellant to five years probation on each of the remaining counts on which he was convicted.

III. FACTS

In 1976, Dahlstrom began to promote and sell a tax shelter program he had devised. At various times thereafter, Ripley, Conley, Morris and Durst joined in the promotion and sale of the program.

Sales of the program took the form of sales of membership in an organization that Dahlstrom had formed called, the American Law Association (ALA). Purchasers of the program bought membership in the ALA. As members, they were entitled to receive instruction and materials relating to the tax shelter program at ALA two-day seminars. Members attending these ALA seminars were charged fees ranging from $6,000 to $12,000.

At these seminars, Dahlstrom and Ripley instructed members on how to create foreign trust organizations (FTO's) in order to reduce their tax liabilities. The members were also provided with forms for setting up such trust organizations and documenting trust transactions. In addition, members received instruction on a "taxpayer defense program" which consisted of lawful actions a member could utilize in the event of an IRS audit. While the program did not include advice or assistance in preparing a member's income tax return, some of the appellants occasionally assisted a member in establishing his FTO by traveling to the designated country and executing the requisite trust documents on behalf of that member.

Members who implemented the ALA tax shelter program caused three trust organizations to be created in a foreign country by a citizen of that country.

Typically, trust number one would be named trustee of trusts two and three, although the person implementing the FTO's retained complete control over all three trusts.

This tax shelter program contemplated that trust number two would be treated as a non-resident alien (purely for tax purposes) and would be subject to tax on payments from the user of the program. In order to reduce trust two's tax liability, purchasers of the program had trust two make payments to trust three. Payments made to trust three would not represent taxable income since trust three would be a foreign entity receiving income from a foreign source.

The final stage of this tax shelter program involved the return to the purchaser of some or all the money he paid to trust number two. In order to achieve this goal, a purchaser would have trust two borrow money from trust three and execute a demand note payable to trust three. Trust three would then transfer the demand note to the purchaser as a gift and the purchaser would demand and receive payment from trust two. This method was premised on 26 U.S.C. § 102 (IRC), which excludes gifts from gross income for income tax purposes, and IRC section 2501 which provides a gift tax exemption for gifts of intangible property by a non-resident alien to a citizen of the United States.

The thrust of the government's case depended in large part on evidence of the trusts and subsequent tax return of Dr. John Ricketts. In November of 1977, Dr. Ricketts expressed interest in the ALA program and attended introductory meetings. Dr. Ricketts' accountant ultimately advised against use of the ALA tax shelter program.

After discussions with his accountant, however, Dr. Ricketts asked O'Leary, a former IRS investigator, to review a tape he had made of a December meeting of the ALA. Shortly after submitting the tape to O'Leary, Dr. Ricketts was contacted by Randy Draughon, an agent for the IRS Criminal Fraud Investigation Division. Agent Draughon returned Dr. Ricketts' tape and asked him to assist in an investigation of the ALA.

In November of 1978, Dr. Ricketts attended an ALA two-day seminar. He was accompanied by IRS agent Walter Perry, who posed as Vince Paoli, a financial advisor to Dr. Ricketts. In order to assist the IRS investigation, Dr. Rickets authorized appellant Conley to implement the ALA tax shelter program in Belize.

After Dr. Ricketts' trusts were set up, Dahlstrom and Conley advised Agent Perry and Ricketts on creating a deduction by repurchasing his tax package from one of his trusts. Conley also recommended that Ricketts obtain accounting services from Durst. Though it was not his general practice to prepare tax returns for ALA members, Durst agreed to do so for Dr. Ricketts.

Durst advised Agent Perry that Dr. Ricketts could deduct $50,000 for 1978, for the repurchase of his tax package from his trust number two if the check had been written before the end of December, 1978. On March 30, 1979, Agent Perry received the tax return that Durst had prepared for Dr. Ricketts. On the return, Durst had taken a deduction for Dr. Ricketts' repurchase of the tax shelter package. Agent Perry fowarded the return to IRS Special Agent Don Jensen. Dr. Ricketts was not concerned with the validity of this return since he had been advised by

Agent Jensen that the Durst return would not represent his true return with the IRS.

This investigation resulted in the return of a seven-count criminal indictment based upon Dr. Ricketts' transaction and a number of similar transactions involving other appellants.

IV. SUFFICIENCY OF THE EVIDENCE

A. *Counts II-VI*

Counts II through VI charged the defendants with various violations of section 7206(2) of the Internal Revenue Code. This section imposes criminal sanctions against anyone who "willfully aids or assists in, procures, counsels, or advises the preparation or presentation under, the internal revenue laws, of a return, affidavit, claim, or other document, which is fraudulent or is false as to any material matter. . . ." 26 U.S.C. § 7206(2). Appellants contend that the government's proof was insufficient to establish that they willingly and knowingly aided in the presentation and preparation of false income tax returns.

In order to convict a person under section 7206(2), the government must prove the following elements of the offense beyond a reasonable doubt:

1. That defendants aided, assisted, procured, counseled, advised or caused the preparation and presentation of a return;
2. That the return was fraudulent or false as to a material matter; and
3. That the act of the defendant was willful. *United States v. Perez*, 565 F.2d 1227, 1233-34 (2nd Cir. 1977); *United States v. Crum*, 529 F.2d 1380 (9th Cir. 1976).

The Supreme Court has defined the term "willfully" under section 7206 to mean a "voluntary intentional violation of a known legal duty." *United States v. Pomponio*, 429 U.S. 10, 12, 97 S.Ct. 22, 23, 50 L.Ed.2d 12 (1976); *United States v. Drape*, 668 F.2d 22, 26 (1st Cir. 1982). We have determined that the term "willful" under the statute "requires proof of a specific intent to do something which the law forbids; more than a showing of careless disregard for the truth is required." *United States v. Brooksby*, 668 F.2d 1102, 1104 (9th Cir. 1982).

The dispositive issue in this case is whether the evidence shows that appellants acted with the specific intent to violate section 7206(2). We have concluded, when viewed in the light most favorable to the government, that the evidence was insufficient to support a finding that appellants possessed a specific intent to violate section 7206(2).

In order to meet its burden of proof as to the appellants' willfulness, the government relies upon three major contentions. First, the government asserts that the FTO's advocated by the ALA had no economic substance and were therefore blatant shams. Second, the government argues that the "taxpayer defense program" could reasonably be found to be inconsistent with a belief in the legality of the tax shelter program. Finally, the government points to some statements made by appellant Durst to show that the appellants had guilty knowledge.

In support of its first contention, the government argues that the law is clear that economic realities of a transaction rather than form are controlling for tax purposes. Consequently, the government asserts that the appellants were well aware of the inherent illegality of the tax deductions which flowed from use

of the ALA tax shelter program. The government, however, has not pointed to any cases which invalidated the FTO's presented in this particular case. Moreover, the government's own expert witness, Karl K. Krogue, testified that the trusts created through implementation of the ALA tax shelter program were valid legal entities.

The government's reliance on *Zmuda v. Commissioner*, 79 T.C. No. 714 (1982), is misplaced. *Zmuda* did not address the issues of good faith, intent, or belief in the legality of the deductions. The sole issue before the tax court was whether Zmuda's FTO's had a business purpose, and if the claimed deductions were valid. We further note that *Zmuda* was a civil proceeding. It was not decided until some ten months after these appellants had been convicted. Due process requires that a person be given fair notice as to what constitutes illegal conduct so that he may conform his conduct to the requirements of the law. *United States v. Batchelder*, 442 U.S. 114, 123, 99 S.Ct. 2198, 2203, 60 L.Ed.2d 755 (1979). Reliance on *Zmuda* as establishing an ex post facto determination that the ALA tax shelters were illegal would not afford the appellants that fair notice.

The government's assertion that the law was clear as to the application of substance over form in criminal prosecutions under section 7206(2) is further contradicted by the evidence at the time of trial. The use of foreign trusts to save taxes was still a highly debatable issue. Darrell D. Hallett, Regional Counsel for the IRS in Seattle, called as a witness for the prosecution, testified that his office had been approached by a number of practioners who were confused as to the laws dealing with foreign trusts. This confusion prompted the Deputy Director of the

IRS to issue a position paper regarding the use of foreign trusts. We note that this position paper was not issued until August 8, 1979. The indictment in this matter was premised upon actions which occurred before the issuance of the paper.

Even if we were to assume that appellants were negligent in continuing to promote the ALA tax shelter program in light of the IRS's adverse position paper, the law is clear that "degrees of negligence only give rise in the tax system to civil penalties." *United States v. Bishop*, 412 U.S. 346, 360, 93 S.Ct. 2008, 2017, 36 L.Ed.2d 941 (1972). The criminal law concerns itself with willful violations of tax law, *United States v. Brooksby*, 668 F.2d at 1102; and "its purpose is not to penalize frank differences of opinion." *United States v. Bishop*, 412 U.S. at 361, 93 S.Ct. at 2017.

We are convinced that the legality of the tax shelter program advocated by the appellants in this case was completely unsettled by any clearly relevant precedent on the dates alleged in the indictment. "It is settled that when the law . . . is highly debatable, a defendant—actually or imputedly—lacks the requisite intent to violate it." *United States v. Critzer*, 498 F.2d 1160, 1162 (4th Cir. 1974). A criminal proceeding pursuant to section 7206 "is an inappropriate vehicle for pioneering interpretations of tax law." *United States v. Garber*, 607 F.2d 92, 100 (5th Cir. 1979).

As noted above, the government asks us to find that the ALA's use of a taxpayer defense program is sufficient proof of a specific intent to violate section 7206 (2). Even the government concedes, however, that the actions recommended in the taxpayer defense program were not unlawful (Gr. Br. p. 27). We are unpersuaded that the appellant's advocacy of various

lawful actions translates into proof that the appellants were aware of the illegality of their tax shelter program.

Even if the defendants knew that a taxpayer who actually performed the actions they advocated would be acting illegally, the first amendment would require a further inquiry before a criminal penalty could be enforced. With the exception of Durst, no defendant actually assisted in the preparation of any individual tax form. Rather, they merely instructed an audience on how to set up a particular tax shelter. Nothing should be clearer at this stage in the development of first amendment jurisprudence than "the principle that the constitutional guarantees of free speech and free press do not permit a State to forbid or proscribe advocacy . . . of law violation except where such advocacy is directed to inciting or producing imminent lawless action and is likely to incite or produce such action." *Bradenberg v. Ohio*, 395 U.S. 444, 447, 89 S.Ct. 1827, 1829, 23 L.Ed.2d 430 (1969) (per curiam).

Nothing in the record indicates that the advocacy practiced by these defendants contemplated *imminent* lawless action. Not even national security can justify criminalizing speech unless it fits within this narrow category; certainly concern with protecting the public fisc, however laudable, can justify no more.

Finally, the government cites several statements made by Durst as sufficient to show the appellants' requisite intent. Although these statements may have been admissible against *Durst* as admissions upon proof of a corpus delecti of some crime, they were clearly inadmissible as proof of the crimes charged against the other appellants.

In order for the statement of a coconspirator to be admissible against his fellow conspirators under Rule 801(d)(2)(E), Fed. R. Evid., the government must establish substantial independent proof of the existence of the conspiracy. *United States v. Perez*, 658 F.2d 654, 658 (9th Cir. 1981); *United States v. Eubanks*, 591 F.2d 513, 519 (9th Cir. 1979). As we explain below, there is no independent proof of a conspiracy. Therefore, these statements could not be used against Durst's codefendants for any purpose.

We conclude that proof of the requisite intent to violate section 7206(2) is not shown in this record.

B. *Count VII*

Count VII related to the tax return prepared by Durst for Dr. John Ricketts. This return was never filed with the IRS. It was never intended to represent Dr. Ricketts' true return with the IRS. (RT: 2395-96). The government contends that an offense under section 7206(2) may be committed without the filing of a document. We disagree.

In *United States v. Habig*, 390 U.S. 222, 88 S.Ct. 926, 19 L.Ed.2d 1055 (1968), the Supreme Court specifically stated that the crime of fraudulent preparation of a tax return is "committed at the time the return is filed." *Id.* at 223, 88 S.Ct. at 927. Other courts have arrived at similar conclusions.

In *Butzman v. United States*, 205 F.2d 343 (6th Cir. 1953), the defendant argued that the statute of limitations started to run on the day the fraudulent return was prepared, not the later date upon which it was filed. In rejecting the argument, the court stated "[n]o crime was committed by Butzman until the application was filed. No crime would have been

committed if the application had not been filed." *Id.* at 351. *See also United States v. McGee*, 572 F.2d 1097 (5th Cir. 1978) (offense of filing a fraudulent return is complete at the time of filing).

We find that the filing of a return is in fact an element of a section 7206(2) violation. Since the return prepared by Durst was never filed, each appellant's conviction under count VII must be set aside.

C. *Conspiracy*

Appellants were convicted of conspiracy to defraud the United States by impeding, impairing and obstructing the IRS in the ascertainment, computation, assessment and collection of income taxes. 18 U.S.C. § 371. The appellants contend that they lacked the necessary intent to commit the substantive offense. We agree.

We have determined that the government must prove the following elements in order to sustain a conviction for conspiracy:

1. Agreement to accomplish an illegal objective;
2. Coupled with one or more overt acts in furtherance of the illegal purpose; and
3. The requisite intent to commit the substantive offense.

United States v. Melchor-Lopez, 627 F.2d 886 (9th Cir. 1980).

"It is hornbook law that when knowledge of a fact is required to convict for a substantive offense, knowledge is also required to convict for conspiracy to commit the substantive offense. *Ingram v. United States*, 360 U.S. 672, 678, 79 S.Ct. 1314, 1319, 3 L.Ed.2d 1503 (1969); *United States v. Eaglin*, 571 F.2d 1069, 1074 (9th Cir. 1977); *United States v.*

Bekowies, 432 F.2d 8, 14 (9th Cir. 1970). "Conspiracy to commit a particular substantive offense cannot exist without at least the degree of criminal intent necessary for the substantive offense itself." *Ingram v. United States*, 360 U.S. at 678, 79 S.Ct. at 1319.

What we have said concerning the insufficiency of the evidence as to counts II through VI is also dispositive of the conspiracy count. The government's failure to present evidence as to the appellants specific intent to violate the underlying substantive count requires us to set aside the convictions premised upon 18 U.S.C. § 371.

V. CONCLUSION

The government has failed to establish that the appellants advocated a tax shelter program with the specific intent to violate section 7206(2).

These appellants were prosecuted in spite of the fact that no statute, regulation or court decision gave fair warning that advocacy of the creation of lawful foreign trust corporations as a tax shelter would result in a criminal prosecution if the challenged transaction might later be held to lack economic substance for purposes of a civil tax proceeding.

Prosecution for advocacy of a tax shelter program in the absence of any evidence of a specific intent to violate the law is offensive to the first and fifth amendments of the United States Constitution.

The judgments are REVERSED.

GOODWIN, Circuit Judge, dissenting:

The majority's opinion finds that what defendants assisted, counselled, and advised their client to do was not clearly illegal at the time they gave the advice and assistance. The majority therefore finds a failure of "proof of a specific intent to do something which the law forbids," *U.S. v. Brooksby*, 668 F.2d 1102, 1104 (9th Cir. 1982). The opinion notes that *Zmuda v. Commissioner*, 79 T.C. No. 714 (1982) was not decided until ten months after these convictions.

The government specifically did not rely on *Zmuda*. It had no need to so rely. It relied on settled principles of tax law regarding sham "gifts" and transactions. Defendants advised their clients to use sham transactions to evade taxes. Such schemes have been illegal since *Gregory v. Helvering*, 293 U.S. 465, 469-70, 55 S.Ct. 266, 267-68, 79 L.Ed.2d 596 (1935) and *Knetsch v. United States*, 364 U.S. 361, 81 S.Ct. 132, 5 L.Ed.2d 128 (1960). See also *Barnett v. C.I.R.*, 364 F.2d 742 (2nd Cir. 1966); *Lynch v. C.I.R.*, 273 F.2d 867 (2nd Cir. 1959). There were no "gifts" here within the clear intent of the statute because the taxpayers controlled the transactions of their trusts. See *Hilda M. Royce*, 18 T.C. 761 (1952); see also *Jackson*, 32 BTA 470 (1935); *Stine*, 32 BTA 482 (1935).

Defendants' knowledge that they were advising and assisting illegal tax evasion is obvious from the record. Defendant Morris provided client Howlett false employer identification numbers to be used in connection with the sham trust bank accounts. Defendant Durst recommended that client Ricketts set up additional sham trusts to make future transactions more difficult for the I.R.S. to trace. Defendants Ripley and Durst recommended that clients use blue "copy-not" pens to sign checks so that I.R.S. agents

could not read them on bank microfilm records. Defendant Morris instructed client Dr. Howard Bean to use specified fictitious names as the authorized signatures on bank accounts opened for the trusts and Morris accompanied Bean when Bean opened accounts using the fictitious names supplied by Morris. Bean also followed Morris's advice and used a false name on a non-resident alien tax return he filed for one of his sham trusts. Defendant Durst counselled clients to alter their Social Security numbers on trust bank accounts to prevent the I.R.S. from tracing them.

Defendants clear knowledge of the illegality of their scheme was evident in the affidavit they required all participants to sign stating that they would not aid any governmental unit or agency in any civil, *criminal*, or administrative action against the defendants, and that the member would not divulge to any governmental agency any information concerning his relationship with the defendants. Defendant Durst explained to "client" Paoli (I.R.S. Special Agent Perry) why all the strategies for concealment were necessary. "If they (the I.R.S.) get ahold of your books or records, they could probably shoot holes in this thing. . . . Yeah if they do you're in trouble . . . . Then you're talking about tax avoidance, tax fraud, and the whole thing." There could hardly be any clearer evidence that the defendants in this case knew that what they were advising and assisting clients to do was patently illegal.

Defendants did more than advise taxpayers. They committed acts in furtherance of the conspiracy. Defendants Conley and Morris traveled to Belize and the Turks and Caicos Islands to set up sham trust organizations for the taxpayers. Defendants Conley, Ripley and Morris also actively assisted taxpayers in opening

bank accounts for the sham trusts. And defendant Durst prepared a fraudulent tax return.

Attendance at ALA meetings and distribution of ALA membership fees established membership in the conspiracy for all defendants except Durst. Defendant Durst attended ALA meetings but did not receive distributions of membership fees. But he did counsel his clients to participate in the scheme and agreed with his co-conspirators that he would prepare tax returns claiming deductions based on the ALA program. Durst thus participated in the conspiracy and by counselling his clients to file fraudulent tax returns he committed a substantive offense in furtherance of the conspiracy.

Durst did more. He actually prepared a fraudulant tax return that he believed his client, Dr. Ricketts, would file and he thus violated 26 U.S.C. § 7206(2). Ricketts did "file" the return, but both Ricketts and the I.R.S. knew that it would not be his true return, because Ricketts was cooperating with the I.R.S. investigation of the scheme.

26 U.S.C. § 7206(2) states:

> "Any person who—. . . (2) . . . Willfully aids or assists in, or procures, counsels, or advises the preparation or presentation under, or in connection with any matter arising under, the internal revenue laws, of a return, affidavit, claim, or other document, which is fraudulent or is false as to any material matter, whether or not such falsity or fraud is with the knowledge or consent of the person authorized or required to present such return, affidavit, claim, or document . . . shall be guilty of a felony and, upon conviction thereof, shall be fined not more than $5,000, or imprisoned not more than 3 years, or both, together with the costs of prosecution."

I cannot agree with the legal conclusion in the majority's opinion that Durst could not have violated 26 U.S.C. § 7206(2) because the return was never "presented" as a true return to the I.R.S.

Title 26 U.S.C. § 7206(2) makes aiding or advising "the *preparation or* presentation" of a fraudulent income tax return a crime. There are no cases in this circuit holding that presentation is a necessary element to the separate crime of fraudulent preparation. To create such a requirement would render the words "preparation or" mere surplusage. For returns that are actually presented, the term "presentation" would be enough to permit punishment of the advisor. The statute was clearly intended to reach tax return preparers whether or not the returns they prepare are ultimately presented. A statute should be construed so that no word, sentence, or clause shall be superfluous. *Ex Parte Public Bank*, 278 U.S. 101, 104, 49 S.Ct. 43, 44, 73 L.Ed. 202 (1928); *Consolidated Flower Ship. v. Civil Aeronautics Bd.*, 205 F.2d 449, 450 (9th Cir. 1953).

The cases cited in the majority's opinion are not in point because all were cases in which the fraudulent return was *both* prepared *and* presented and the question was from what date the statute of limitations should run. *United States v. Habig*, 390 U.S. 222, 88 S.Ct. 926, 19 L.Ed.2d 1055 (1968) held that the government could press charges within six years from the actual filing of the returns, not from the statutory due date. Presentation is a separate act from preparation and the government could prosecute up to six years from that act. There was no holding in *Habig* that the government could not prosecute for fraudulent preparation alone.

Similarly in *Butzman v. United States*, 205 F.2d 343 (6th Cir. 1953), *cert. denied*, 346 U.S. 828, 74 S.Ct. 50, 98 L.Ed. 353 (1953), the Sixth Circuit ruled that the statute of limitations ran from the date of filing, not from the date of preparation. The dicta in *Butzman* that no crime was committed until the application was filed and that no crime would have been committed if the application had not been filed have never been adopted by the Ninth Circuit. The dicta would render the words "preparation or" in § 7206(2) nugatory, and we should not adopt them.

The crime of fraudulent preparation should be deemed complete when the preparer delivers the returns to a client with the belief that the client will file them.

Durst advised Ricketts to back date a check so that he could claim a deduction. And the tax return he prepared for Ricketts included a deduction for "repurchase" of ALA tax shelter documents that Durst knew was a sham. He knew the return he prepared contained false deductions and he therefore violated § 7206(2).

There was no violation of first amendment protected speech or association here. The first amendment does not protect communications that are part of conspiracies to commit unlawful acts. *U.S. v. Buttorff*, 572 F.2d 619 (8th Cir. 1978), *cert. denied*, 437 U.S. 906, 98 S.Ct. 3095, 57 L.Ed.2d 1136 (1978).

Viewing the evidence in the light most favorable to the jury's verdict and drawing all reasonable inferences, there was substantial evidence from which the jury reasonably could have found the defendants guilty beyond a reasonable doubt. *U.S. v. Friedman*, 593 F.2d 109, 115 (9th Cir. 1979); *U.S. v. Jacob-Gil*, 474 F.2d 1213, 1214 (9th Cir. 1973).

APPENDIX B

UNITED STATES COURT OF APPEALS
FOR THE NINTH DISTRICT

C.A. Nos. 82-1137, 82-1138, 82-1141,
82-1142 and 82-1143

D.C. No. CR 81-116 RJR

UNITED STATES OF AMERICA, PLAINTIFF-APPELLEE

vs.

KARL L. DAHLSTROM, HIRAM E. CONLEY,
BRUCE R. RIPLEY, DAVID J. MORRIS,
and GAZE DURST, DEFENDANTS-APPELLANTS

[Filed Nov. 8, 1983]

ORDER

Before: GOODWIN, ALARCON and FERGUSON, Circuit Judges

The panel as constituted in the above case has voted to deny the petition for rehearing and to reject the suggestion for a rehearing en banc.

The full court has been advised of the suggestion for an en banc hearing, and no active judge of the court has requested a vote on the suggestion for rehearing en banc. Fed.R.App.P.(35(b) [*sic*].

The petition for rehearing is denied and the suggestion for a rehearing en banc is rejected.

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